

June 13, 2007

Interim Summary of Issues (Phase 1)

Study Group on the Internationalization of Japanese Financial and Capital Markets

I. Foreword: Desirable State of Financial and Capital Markets

○ In order for the Japanese economy to continue growing in a sustained manner against the backdrop of the increasingly aging population and falling birthrate, it is necessary to effectively utilize financial assets owned by Japan's household sector worth 1,500 trillion yen, and make the financial services industry that generates high added value play a central role in the economy.

○ However, while competition among markets is intensifying further on a global scale, the presence of Japan's financial and capital markets is diminishing in the international arena. There are concerns that at the present rate, the markets might not be able to properly fulfill the roles expected of the financial sector. Underlying factors that have been pointed out include the possibility of risk money not necessarily being supplied smoothly to the economy as the shift of funds *from savings to investments* is still on its way, and concerns in terms of the breadth of human resources and market practices worthy of an international financial center.

○ Therefore, the pressing issue for Japan is to enhance the international competitiveness of its financial and capital markets. This requires the development of markets that are attractive for both domestic and overseas market participants, by further promoting ongoing efforts to reform Japan's financial and capital markets and by expanding their base. This is a high-priority issue at the national level, including but not limited to market players.

○ In a nutshell, the enhancement of the international competitiveness of financial and capital markets is deemed beneficial to the Japanese people as follows:

(1) For investors, it means they will have more advantageous investment opportunities arising from the diverse range of financial instruments and services made available. The growth of Japan's financial and capital markets helps enrich the lives of the entire population in their old

ages, as elderly people with little income cash flow are heavily dependent on returns generated by the assets they have accumulated to prepare for their post-retirement years such as pension contributions, under such circumstances that one in four people will be aged 65 or older in the very near future due to the aging of the population.

(2) For companies seeking to raise funds, external financing needed for business expansion gives them more growth opportunities.

○ The increase in investment returns, combined with the added value generated by the financial services industry serving as an intermediary, will boost national income and be translated into affluence of the entire nation. Furthermore, the development of the financial and capital markets is, through the proper fulfillment of the resource allocation function and governance function, expected to lead to improving the efficiency and productivity of economic activities and have a positive effect on the economy as a whole.

○ Moreover, as part of such a positive growth cycle, it is expected that the encompassing of investment funds from overseas and the attraction of foreign companies whose home countries have limited pool of financial assets in their domestic markets to the Japanese market will not only contribute to the further growth of the Japanese economy, but also contribute to the growth of the global economy, especially the Asian economy.

○ In consideration of the above, in order to build attractive markets that can be used by both domestic and overseas market participants with a sense of security, it is necessary to make comprehensive efforts to not only stimulate the markets and improve their efficiency, but also take steps to ensure transparency and fairness. Specifically, as described in the following pages, a wide range of issues — not only legislative issues but also issues relating to human resources, specialized services and infrastructure — need to be tackled by the government as a whole, and at the same time, by market players in an integrated manner.

II. Issues to be Addressed

1. Conditions of Attractive Markets

(1) Development of Markets with “Depth” through the Provision of Diverse Products and Services

- In order to make Japan’s financial and capital markets attractive to domestic and overseas market participants, it is indispensable to provide products and services with a wide range of risks and returns according to demand, and develop highly-liquid markets with “depth.”

Accordingly, it is necessary to improve market accessibility for overseas companies and domestic small and medium enterprises (SMEs) and start-up companies including those located in local areas that have currently had difficulty in accessing Japan’s financial and capital markets upon raising funds, which will lead to expanding the base of the markets.

With regard to the current state of Japan’s financial and capital markets, there have been suggestions that as far as market “depth” is concerned, the markets are underdeveloped especially for high-yield bonds and credit-related products. In order to improve user convenience in terms of both investment and financing, it is important to develop markets that seamlessly provide diverse financial products and services including derivatives, spanning from equity to debt.

Furthermore, for the development of the markets with “depth”, it is also indispensable that various market players with different risk appetite, including funds (e.g., private equity funds, hedge funds) for instance, participate in the markets.

(2) Sufficient Fulfillment of Market Functions underpinned by Strict Self-Discipline of Market Participants

- In building attractive financial and capital markets in the international arena, it is important that the markets’ functions are sufficiently fulfilled through the provision of diverse products and services.

To this end, it is necessary to make ceaseless efforts to ensure and improve the credibility of the markets, and require all market participants to exercise a high level of self-discipline in addition to the discipline required by statutes and self-regulations.

2. Infrastructure including Systems

(1) Regulatory Environment

- **Building of Better Regulatory Environment (“Better Regulations”)**

- While market competition among major international financial centers has been intensifying

on a global scale in recent years, there has been growing recognition that the regulatory environment is becoming a crucial determinant of the superiority and international competitiveness of markets.

Under these circumstances, as each country has been seeking to build a better regulatory environment (“better regulations”), it is also required in Japan, too, as a regulator’s role to be fulfilled,

(a) to increase the credibility of the financial and capital markets through the ensuring of market functions centering on fair price formation and strict user protection; and

(b) to support the development of Japan’s financial and capital markets through providing a better environment for the providers of financial products and services to make innovation and improving user convenience.

Therefore, the regulatory authorities need to make effort to build a better regulatory environment which utilizes the vitality of private sectors in order to raise the attractiveness of Japan’s financial and capital markets in the international arena.

1) Regulatory Process

● Principle-based Approach and Rule-based Approach

- As for the concept of regulations for the development of a better regulatory environment, there are two approaches, namely, the rule-based approach and the principle-based approach.

In general, the rule-based approach aims to improve the predictability of market participants with respect to regulations by setting rules in detail. In contrast, the principle-based approach aims to encourage the voluntary efforts of market participants while ensuring management freedom by laying down key principles and demanding that those principles be observed.

The question as to which of these two approaches should be emphasized is debated in various ways in foreign countries as well. The regulatory frameworks of foreign countries vary in actual form, as exemplified by countries that divide the market into two (wholesale market and retail market) and adopt a different approach to each of them, and countries that fundamentally apply the rule-based approach but deal with new financial products and trading methods with the principle-based approach.

It is not appropriate to summarize the discussions on these two approaches simply as a matter of “either-or” choice. It is important to implement the two approaches in a mutually complementary, balanced manner, similarly to the views taken by the regulatory authorities of the United Kingdom and the United States.

● Further Clarification of Rule

- In order to improve the predictability of the way in which rules are interpreted and applied, it

is necessary to further promote communication with businesses.

For the Prior Confirmation Procedures on the Application of Laws and Regulations (“No Action Letter System”), a study is underway to expand its scope and review the content and timing of publication as a government-wide initiative. In addition to this, it is also necessary for the Financial Services Agency (FSA) to endeavor to improve the receipt procedures and shorten the response time. Additionally, it is important to encourage the use of the System by making it more widely known.

Furthermore, it is expected that efforts will be made to further clarify the rules, by for example making use of the FAQ (Frequently Asked Questions) format on matters that are frequently queried by businesses.

With all of these efforts, it is important that concrete cases of interpretation and application of rules will be accumulated.

● **Encouragement of Dialogue with Businesses and Enhancement of Information Sources targeting Overseas**

- In order to build an appropriate regulatory environment, it is necessary to encourage interactive dialogue by such means as further increasing opportunities for regulatory authorities and businesses to communicate with each other, including those related to the interpretation and application of rules in individual cases.

Given that the aim is to become an international financial center, it is indispensable to promote the translation of financial laws and regulations into English, and issue press releases in both Japanese and English. For this purpose, it is necessary to bolster the capability in the regulatory authorities to radically enhance overseas public relations divisions.

Furthermore, in order to promote the understanding of the regulatory environment of Japan’s financial and capital markets, proactive efforts should be made to host international conferences, and members of Japanese regulatory authorities should actively participate in symposiums in Japan and overseas and explain their basic approach to regulations.

● **Improvement of Regulatory Authorities’ Skills**

- To properly respond to the advancement of financial technology and the globalization of financial transactions, not only private businesses but also regulatory authorities need to improve their skills. Specifically, they should ceaselessly review their efforts including those related to personnel affairs and training to further improve their skills through such means as promoting dialogues with private businesses, exchanges of information as well as personnel with overseas regulatory authorities, making training programs more advanced, and increase in the expertise.

- **Enhancement of Collaboration with Overseas Authorities**

- As financial transactions are becoming increasingly globalized, due consideration should be given to harmonize the regulations with those of foreign countries to accomplish high-quality regulations in terms of investor protection, in order for Japan to secure a status as having international financial and capital markets.

Moreover, bilateral and multilateral networks to exchange information with overseas regulatory authorities (such as Memorandum of Understanding (MOU) to exchange information on securities) should be expanded and cooperation should be deepened so that proper action can be taken against illicit acts in markets which are becoming increasingly borderless.

In addition, participation in international financial rulemaking should remain active.

- **Enhancement/Reinforcement of Roles and Functions of Self-regulations**

- Self-regulations play a significant role in complementing supervision and market surveillance by regulatory authorities and ensuring fairness and transparency of the market. It is expected that self-regulations will demonstrate their merits in complementing discipline based on laws and regulations, particularly in terms of autonomy, expertise, and flexibility.

As the financial instruments business is expected to be taken up by a wide range of entities following the full implementation of the Financial Instruments and Exchange Law, it is necessary to effectively enforce user protection strictly in a cross-sectoral, loophole-free manner — which is the objective of the said Law — even at the level of self-regulations. To this end, it is important to enhance and reinforce the scope, roles and functions of self-regulations. This also requires the enhancement of the capability of self-regulatory organizations.

From this perspective, it is expected that further progress will be made in ongoing discussions in each industry on how the self-regulatory organizations should be. In doing so, it is expected that the cooperation among self-regulatory organization will be further strengthened.

2) Application of Rules

- **Review of Civil Money Penalty System**

- As a measure to ensure the effectiveness of regulations in the market and prevent violations, the Securities and Exchange Law was revised in 2005 to introduce a civil money penalty system. Since the introduction of this system, the number of recommendations to order a civil money penalty payment totaled 20 as of the end of May 2007, of which 16 were related to insider trading and the remaining 4 were related to misstatements in disclosure documents. This can be deemed as that the civil money penalty system is gaining higher recognition for its effectiveness as a means of enforcement.

To further improve the fairness and transparency of the market and make the deterrent effect more potent, it is necessary to review the concept of the civil money penalty system, including its scope and the level of penalties in amount, in consideration of its past implementation.

Specifically, after considering the results of the ongoing review which is currently under way at the Antimonopoly Act Study Group at the Cabinet Office, a technical study on the legislation side should be conducted before making a conclusion by around the end of 2007.

- **Enhancement of Dispute Resolution System**

- In order to ensure the effectiveness of rules, it is necessary to accumulate ex-post-facto rules through simple and speedy procedures for dispute resolution.

For this purpose, it is necessary to conduct a study to create a high court specialized for finance, securities and commerce and enhance Alternative Dispute Resolution (ADR), with the aim of clarification of rules through the accumulation of judicial precedents and improvement of the predictability of the way in which the laws are applied.

3) Market System

- **Diversification of Financial Products Tradable at Exchanges**

- In order to develop markets with “depth” and make Japan’s financial and capital markets more attractive in the international arena, it is important to improve user convenience by making a wide range of products including those already tradable on foreign exchanges available at domestic exchanges. It is necessary to further study on the improvement of diversification of financial products including the increase of the type of Exchange Traded Funds (ETF), while taking into account investor protection.

- **Expansion of Trading Opportunities of Overseas Companies’ Shares in Japan**

- Trading of overseas companies’ shares in Japan currently requires the direct listing of such companies on a stock exchange or listing them in the form of American Depositary Receipt (ADR) or similar.

In addition to utilizing these methods, the use of Japanese Depositary Receipt (JDR) is one way of further expanding trading opportunities in Japan. However, JDR has not been used in the past due to the ambiguity of grounds for their issuance and the lack of an investor protection framework.

As the treatment of JDR under private law has become clear following the enforcement of the revised Trust Law, it also becomes necessary to promptly clarify the regulatory treatment of JDR by government orders and ordinances to promote transactions using JDR in the future.

- **Stimulation of Transactions among Professionals**

- The expansion of financing opportunities in the Japanese market for overseas companies and domestic unlisted start-up companies will provide such companies with growth funds, and at the same time, help increase profit-earning opportunities for investors managing funds. As a result, it is deemed to increase the “depth” of Japan’s financial and capital markets.

Furthermore, in order to enhance the international competitiveness of Japan’s financial and capital markets, it is important to give greater freedom in the wholesale market and encourage financial innovation through competition among institutional investors and other market participants. On the other hand, in the retail market in which general investors in Japan, consisting mainly of individuals, directly participate, the investor protection framework should be maintained by such means as the statutory disclosure of information, due to the need to be able to trade in the market with a sense of security.

The full implementation of the Financial Instruments and Exchange Law adds flexibility to the regulatory system according to the investor’s attributes and substantially relaxes the application of the code of conduct aimed at closing the information gap in sales and solicitation targeted at professional investors. In addition, for qualified institutional investors, it lowers the base amount of investment in securities relating to business corporations, and substantially expands the scope of qualified institutional investors, including opening up doors for general corporations and individuals to become qualified institutional investors.

Based on such developments, it is important to conduct a study on measures to further stimulate transactions among professionals in the wholesale market, including the trading of high-risk instruments. In conducting such a study, if there are any measures that should be taken, proper action should be taken to implement them in consideration of the needs of the market players.

- **Reform of Green Sheet Market**

- Currently, there is a green sheet market operated by the Japan Securities Dealers Association (JSDA) as a venue for trading of unlisted shares. Despite the gradual increase in the number of tradable shares and the trading turnover, it lacks liquidity and is still insufficient in size compared to the pink sheet market in the United States.

Therefore, there is a need to further improve the market’s resource allocation function in accordance with the level of risks by securing a venue for trading financial products other than listed securities and expanding the base of the market.

Among unlisted stocks, securing a venue for trading delisted shares after they have been delisted is an especially significant issue in view of protecting shareholders and giving delisted companies another chance.

For this purpose, it is necessary that a study is conducted by market players led by JSDA to

make improvements in the Phoenix category — which plays the role of providing a trading venue for delisted companies — in the green sheet market, and that necessary systems are set within 2007.

4) Others

● **Implementation and Utilization of Financial Instruments and Exchange Law**

- The full implementation of the Financial Instruments and Exchange Law leads to the development of a legal system that is not inferior to securities markets legislations in the U.S. or Europe, owing to the development of laws that enable both the protection of general investors and the promotion of financial innovation.

Specifically, it takes measures with globalization in mind, as exemplified by the various conventional vertically-structured industry regulations, which, in principle, have been consolidated into a single registration system as a financial instruments business, and by relaxing the entry requirement for funds targeting professional investors as requiring a notification instead of requiring registration. It is expected that these measures will encourage the entry of diverse participants into the market, and help diversify services made available to customers and diversify the providers of risk money.

In consideration of the above, it is important to properly and smoothly implement the Financial Instruments and Exchange Law, which may be regarded as a vital platform to enhance the international competitiveness of Japan's financial and capital markets.

From this perspective, supervisory guidelines and inspection manuals targeted at financial instruments firms are currently being amended. The Financial Instruments and Exchange Law should be properly implemented through appropriate supervision, inspection and surveillance based on the amended guidelines and manuals.

● **Approach to Firewall Regulations for Banking and Securities Businesses**

- Firewall regulations concerning banking and securities businesses were established to prevent conflict of interest, the abuse of dominant position by financial institutions when, as part of the reform of the financial system in 1993, mutual entry became available by establishing a subsidiary for each type of business. Since then, the regulations have been relaxed step by step in consideration of the actual circumstances.

However, the following have been pointed out as the existing firewall regulations prohibits, in principle, the exchange of undisclosed information on customers in business operations as a financial group.

- It hinders financial innovation to provide comprehensive services to customers as a financial group.

- It obstructs consolidated risk management and compliance required as a financial group.
- Especially for overseas financial institutions, the administrative costs associated with developing a structure to comply with the regulations are increasing.

On the other hand, also pointed out are that the grounds for the existing firewall regulations, namely, the possibility of conflict of interest and the abuse of dominant position by financial institutions, are still critical points at issue to this day, and that it may be necessary to take into account the significant economic influence of banks in Japan, which still hold a dominant position, as well as customers' concerns over information being shared within financial groups.

Therefore, a study on how the firewall regulations concerning banking and securities businesses should be needs to be launched promptly at the Financial System Council to make them adequate, with the view to improve user convenience and ensure appropriate and efficient business operations of financial institutions, and to prevent conflict of interest and the abuse of dominant position by financial institutions.

- The aforementioned problems such as conflict of interest do not only arise between banking and securities businesses; for example, they may similarly arise between divisions of a securities company (group) or between subsidiaries other than a bank or a securities company belonging to the same financial group. Therefore, study should be conducted also on effective measures to prevent conflict of interest in financial groups broadly, including but not limited to that between banking and securities businesses.

It is also necessary to conduct a study on the regulations including that on the scope of operations of financial groups, in consideration of the purpose of the regulations and the characteristics of the operations, bearing in mind that the demand for new financial operations is increasing in line with the advancement and diversification of financial services.

(2) Other Institutional Infrastructures

● Settlement system

- The settlement systems are key infrastructure underpinning financial and capital markets, and the level of security, efficiency, and convenience form one of the crucial determinants of the international competitiveness of financial and capital markets.

Efforts to improve the settlement systems are currently underway, as exemplified by the upgrading of the Bank of Japan Financial Network System (BOJ-NET) to next-generation Real Time Gross Settlement (RTGS) for the settlement of funds and the implementation of the book-entry transfer system for the settlement of securities. In order to enhance the international competitiveness of Japan's financial and capital markets, it is important to further improve the security, efficiency and convenience of the settlement systems in response to the

advancement of information technology and the trends towards cross-border financial and capital transactions.

For the future, it is expected that interested parties will voluntarily and proactively make efforts to enhance the settlement systems and continue conducting specialized studies on various points at issue concerning the settlement systems from a broad perspective.

- **Introduction of Scheme to Encourage Asset Formation among Individuals**

- In order to further accelerate the shift of funds *from savings to investments*, it is necessary to expand the population of individual investors participating in the market.

Given the increasingly aging population and falling birthrate, it is necessary to look into enhancing the Japanese version of 401k (defined contribution pension plan) system including the rules of contribution and the tax system so that people can secure more reserves for their old age, by drawing upon the Individual Retirement Account (IRA) of the United States and the Individual Savings Account (ISA) of the United Kingdom.

- **Tax System**

- It is natural to look at the rate of return on investment in the context of the ultimate rate of return after tax. As such, financial products and services and the taxes imposed on them are inextricably linked to each other.

As the financial and securities tax system plays a significant role in further accelerating the shift of funds *from savings to investments*, it is necessary to discuss the approach to the financial and securities tax system with the aim to minimize the distortion of the market by the tax system in terms of the tax burden at both corporate and individual level, in a manner consistent with the basic reform policy to restructure the financial system into a market-oriented one.

- As some market participants who invest in Japan seem to be taking the move to operate from bases in neighboring international financial centers for the purpose of tax avoidance, it is necessary to discuss the approach to Japan's tax system as a whole in the future, including but not limited to the financial and securities tax system, in order to enhance the international competitiveness of Japan's financial and capital markets and secure a reasonable level of employment and tax revenue.

- **Human Resource Education**

- The existence of highly specialized human resources is deemed to be the most fundamental and crucial factor for enhancing the international competitiveness of Japan's financial and capital markets, as is the case obviously in London, New York and other such international financial

centers.

To this end, it is necessary that not only each and every player participating in the financial and capital markets makes efforts in personnel development and increases its base individually, but also the approach to education systems and the personnel and training systems at companies needs to be reviewed. To this end, universities, companies, the government and other interested parties need to unite and work on this together.

As an international financial center, Japan is undeniably in a disadvantaged position in terms of the breadth of personnel who are fluent in English for being a non-English-speaking country compared to other international financial centers such as Hong Kong and Singapore. As an educational issue, it is important to improve language skills broadly for communication in English, in addition to specialization in finance and peripheral services.

(3) Physical Environment

1) Urban Infrastructure

• Development of Urban Infrastructure as an International Financial Center

- In order to improve the urban functions as an international financial center, it is necessary to encourage the clustering of various market participants including not only financial institutions but also peripheral specialized service providers such as legal and accounting firms, and actively endeavor to develop urban infrastructure in which both domestic and overseas players can operate safely and comfortably.

To this end, it is important to promote joint initiatives by public and private sectors through the collaboration of financial administration and urban redevelopment measures. From this perspective, it is necessary to collaborate with the Urban Renaissance Headquarters and work towards the promotion of urban renaissance projects.

Furthermore, it is expected that interested parties in the private sector will also make voluntary efforts in this area.

2) Transportation Infrastructure

• Improvement of Access to International Airports

- In order to improve Japan's functions as an international financial center, it is necessary to provide easy access to other international financial centers and major cities in Asia.

For this purpose, it is important to improve access to international airports, such as shortening the travel time taken from international airports to the city center, and to improve the convenience of airline routes connecting Japan to other international financial centers and major cities in Asia.

3) Other

- **Development of Living Environment to Bring in Human Resources**

- In order to enhance the international competitiveness of Japan's financial and capital markets, it is necessary to bring in competent human resources regardless of nationality as active players in the Japanese market. To this end, it is important to develop an environment that is easy to live in for foreigners, in terms of education, medical care and various other aspects.

Work needs to be done in this area in the course of promoting urban redevelopment projects.

3. Issues to be Tackled by Market Participants (Players)

(1) Market Operators

- **Promotion Activities to Bring in Overseas Companies into the Japanese Market**

- In order to boost the presence of Japan's financial and capital markets in the international arena, it is necessary to encourage overseas companies to raise funds in the Japanese capital market. Especially considering that the number of foreign companies listed on the Tokyo Stock Exchange (TSE) has decreased from 127 in 1991 to 25 at present, it is important to encourage overseas companies to list solely on a Japanese stock exchange, instead of just relying on dual listings (listing on a Japanese stock exchange and an overseas stock exchange at the same time) as dually-listed overseas companies are more likely to retreat to the market in their home country.

Therefore, it is expected that interested parties including stock exchanges will engage in aggressive promotion activities to attract and encourage overseas companies to list on a Japanese stock exchange.

- **Diversification of Instruments Tradable at Stock Exchanges**

- In order to make Japan's financial and capital markets more attractive in the international arena, it is important to improve user convenience by making a wide range of products available to investors at stock exchanges. It is expected that each stock exchange will make proactive efforts in this regard, taking into account the needs of market participants, while heeding investor protection.

- **Enhancement of Self-regulatory Functions**

- For the purpose of building a market in which both domestic and overseas investors can trade with a sense of security, improving the governance of publicly-held companies is also an important issue. To this end, it is expected that each stock exchange will make voluntary efforts, including the prompt establishment of the "Corporate Code of Conduct" as set forth in

the “Development of Comprehensive Improvement Program for Listing System 2007” published by the TSE.

In order to ensure the effectiveness of the self-regulatory functions of stock exchanges, it is necessary for the stock exchanges themselves to diversify the sanctioning measures such as monetary penalties, and enhance their stance by ensuring due process upon the implementation of such measures. It is expected that a proper approach will be taken in consideration of the studies conducted by the stock exchanges and other interested parties.

(2) Companies seeking to Raise Funds

• Improvement of Capabilities and Understanding of Corporate Finance, Legal Affairs and Accounting

- For companies seeking to raise funds with the aim of attaining further growth through the injection of external funds, it is expected that financing opportunities will increase as a result of gaining access to the capital market. To use the capital market, however, it is important that the companies themselves fulfill their accountability to domestic and overseas investors by improving corporate governance and developing internal control systems, as well as realize the satisfactory returns as expected by investors. It is also important for them to

In addition to the introduction of an internal control report system over financial reporting pursuant to the implementation of the Financial Instruments and Exchange Law, it is necessary for companies seeking to raise funds to improve their capabilities regarding corporate finance, legal affairs and accounting and promote financing based on proper understanding. It is expected that interested parties will make voluntary efforts in this regard.

(3) Individual Investors

• Improvement of Financial Literacy through Further Enhancement of Financial and Economic Education

- The existence of individual investors underpinning the base of markets is important in building a market with “depth.” To encourage individual investors to participate in the market, it is necessary to improve their financial literacy by further enhancing financial and economic education so that they can make appropriate investment decisions.

To this end, it is expected that the FSA, the Central Council for Financial Services Information and other interested parties will make further efforts including creating more opportunities for financial and economic education targeted at individual investors.

(4) Institutional Investors

• Improvement in Quality of Institutional Investors underpinning Market-oriented Indirect

Financing

- When restructuring the Japanese financial system into one that has market functions at its core, it is necessary to further accelerate the shift of funds *from savings to investments* and encourage people to broadly participate in the market. In crystallizing this shift, indirect participation in the market through institutional investors — so-called market-oriented indirect financing — plays a significant role.

In market-oriented indirect financing, it is indispensable for institutional investors (e.g., pension funds, investment trusts and insurance companies) to endeavor to maximize profits for beneficiaries (i.e., pensioners, ordinary investors and policyholders) and fulfill their fiduciary duties* while exercising their expertise in collecting information and managing risks.

With respect to the actual state of institutional investors in Japan's financial and capital markets, it has been pointed out that portfolio diversification remains limited and governance is still not sufficiently demonstrated through the exercise of voting rights, compared to foreign countries, and that their fiduciary duty to pensioners, general investors and policyholders may not be fulfilled sufficiently.

It has also been pointed out that the rate of return on assets invested in the market by institutional investors does not necessarily meet the level of expectations of pensioners and others.

Thus, with regard to the fund management of public pension, there have been various discussions in the Study Group, varying from the discussion from the viewpoint of vitalizing financial and capital markets to that on the public pension system itself. During these discussions, emphasis was made on the necessity of prompt implementation of concrete measures to make pension funds including the public ones, investment trusts, insurance companies and other such institutional investors compete with each other in diversifying investment choice and techniques (e.g., use of alternative investment) when they manage the funds in the market, and to meet the expectation of beneficiaries.

It is expected that institutional investors will improve their risk-taking abilities and investment techniques by such means as reviewing the personnel and remuneration systems of fund managers, and at the same time, sufficiently fulfill their fiduciary duties.

* Note: Here, the term “fiduciary” is not synonymous with the term “trustee” generally used in trust agreements in Japan, but is used as a broad concept that refers to “fiduciary” in the Western context, that is, a person who is required to perform a certain range of duties with the consent of another party. Various responsibilities assumed by the fiduciary are collectively and broadly referred to as “fiduciary duties”. Fiduciary duties specifically consist of accountability, duty of segregated custody, duty of loyalty (duty to prevent conflict of interest),

and duty of care of a good manager.

(5) Financial Intermediaries

• Efforts to be made by Japanese Financial Institutions for Financial Innovation

- In order to enhance the international competitiveness of Japan's financial and capital markets, it is important to, at the same time as ensuring user protection, improve user convenience by promoting competition in financial and capital markets through increasing competitiveness of financial institutions whose mother market is in Japan.

To that end, it is necessary for each financial institution to, based on its own management decision, exercise creativity and make effort for financial innovation. It is also expected to ensure risk management through the diversification of portfolio for instance.

In this respect, it is expected that companies change their awareness at the management level to effectively utilize personnel in-house, including corporate culture, work environment, work arrangement, personnel affairs, and remuneration.

• Training of Personnel who can Provide More Advanced Financial Products and Services and Expansion of Population of Such Personnel

- It has been pointed out that many Japanese financial institutions lag behind their foreign counterparts in providing more advanced financial products and services because of the lack of highly specialized personnel.

In order to meet customers' needs and promote the provision of diverse and advanced financial products and services, it is important to train and enhance personnel with financial expertise and skills and increase the breadth of such personnel. It is expected that the private sector will make voluntary efforts in this field.

(6) Peripheral Services

• Personnel Training and Expansion of Population of Personnel to Enhance Legal and Accounting Services

- In order to provide and use advanced and international financial products and services, it is important to train and enhance legal experts and accounting specialists and other such personnel engaged in peripheral services to be knowledgeable on finance and international transactions, and increase the breadth of such personnel.

Specifically, it is expected that relevant parties will make such efforts as enhancing higher education at finance-related business schools, law schools and accounting school.

Another issue that should be studied in the future is the development of frameworks and qualification systems aimed at training experts who will take charge of compliance in financial

instruments transactions.

III. Afterword

○ Issues pointed out by the Study Group are to be addressed by a wide range of entities, including those that ought to be addressed by the government including regulatory authorities and those that should be left to voluntary and proactive efforts by the private sector. It is expected that all interested parties will work on their respective issues in a serious manner.

○ In order to overcome these issues, it is necessary to build an effective promotion framework. Accordingly, broad issues that relate to the reform of financial and capital markets should be regarded as vital challenges for the Cabinet in the form of a comprehensive package named, for example, “Plan to Enhance Competitiveness of Financial and Capital Markets of Japan (tentative name)”. With respect to each issue, the priority order and target implementation date should be clarified to the extent possible, and the issues should be tackled in a speedy fashion, starting with the ones for which solutions are available.

○ Especially with respect to issues that require institutional arrangements, further studies should be conducted in the future — including addressing the legislation side — at an appropriate venue arranged at the Financial System Council.

○ In carrying out these initiatives, it is indispensable to gain broad support from the public, and it is necessary for the government and other interested parties to endeavor to actively step up the dissemination of information to gain people’s understanding of the necessity of enhancing the international competitiveness of financial and capital markets and the resulting benefits in people’s lives.

○ The internationalization of Japan’s financial and capital markets will not happen overnight. It is necessary to ceaselessly make efforts in consideration of the changes in the financial and economic climate and customers’ needs while examining the effects of reform measures. The Study Group will keep an eye on the progress of these initiatives, and continue to deepen discussions including those on additional issues towards internationalization.

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